The Canadian Institute of Strategic Studies
STRATEGIC DATALINK
de L'Institut Canadien D'Études Stratégiques

SHORT-TERM GAIN, LONG-TERM PAIN: THE CANADIAN DEFENCE BUDGET DILEMMA

Philippe Lagassé
Strategic Datalink #118
March, 2004

Economic constraints lie behind each Canadian defence policy decision. Every deployment, procurement choice and alliance membership entails opportunity costs and budgetary implications. In spite of this fact, the Canadian defence community has traditionally devoted little time to economic issues.[1] Too often, those who study defence issues see fiscal realities as an unfortunate limit on what Canadian defence policy 'ought' to accomplish. Indeed, it is often held that the Canadian government should first determine what military capabilities it needs before deciding how much of the federal budget should be allocated to defence.

In his book *While Canada Slept*, Andrew Cohen argues that Canada should reinvest in military assets to regain the international stature it had following the Second World War.[2] Absent from Cohen's work is an analysis of how such a reinvestment will impact other federal programs which did not exist during this 'golden age' of Canadian internationalism. Similarly, in its report, *In the National Interest: Canadian Foreign Policy in an Insecure World*, the Canadian Defence and Foreign Affairs Institute (CDFAI) recommends that the Canadian government increase the number of regular force military personnel from 60,000 to 80,000.[3] The report does not mention how its recommendation will affect the federal government's debt reduction priorities. This is not to say that the findings of Cohen and CDFAI are wrong or naïve. It does suggest, however, that the solutions they propose are unlikely to be heeded by the fiscally-minded in Ottawa.

In an apparent departure from the defence community's aversion to economic analyses, the School of Policy Studies at Queen's University and the Conference of Defence Associations (CDA) produced an economically-oriented study of the Canadian military in December of 2003.[4] Entitled, *Canada Without Armed Forces?* the study examines shortfalls the Canadian Forces (CF) will face in the future if significant funds are not injected into the Canadian defence budget. The study also outlines how an emphasis on operations and maintenance has reduced the CF's ability to acquire new equipment. To offset these predicted shortfalls, the study argues that Ottawa should review Canada's defence policy, and increase and reorganize the defence budget.

Like its contemporaries, *Canada Without Armed Forces?* is silent on how its recommendations would fit in with Ottawa's other fiscal concerns. It is therefore worthwhile to ask whether it is fiscally prudent to increase Canadian defence spending and, if not, what alternatives should be considered to address the capabilities crisis identified by the authors of *Canada Without Armed Forces?*

This paper examines Canada's defence budget dilemma. The argument here is that current military expenditures are adequate to meet the government's defence policy objectives, and that a significant increase in defence spending would undermine Canada's economic security. It is also argued, however, that the distribution of the defence budget is undermining the long-term viability of the CF. As a result, Canada may have to narrow the range of capabilities in its inventory. Doing so would fortify Canada's economic security while ensuring that the CF is equipped to execute government policy in the future.

Canadian Defence Spending

Canada spends approximately $13-billion on defence. This amount represents a small portion - roughly 1% - of the Canadian gross domestic product (GDP). Compared to other Western nations, spending only 1% of GDP on defence appears lax. Indeed, Canada is often accused of being a military free-rider, spending as little as possible on the CF while relying on the United States military to protect Canadian interests. A comparative analysis of North Atlantic Treaty Organization (NATO) defence spending figure reinforces this assessment.[5] As a percentage of GDP, Canada's military expenditures ranked 17th in NATO in 2003. This places Canada behind other middle-powers such as Italy and Poland, and ahead only of Luxembourg. Coupled with the fact that 2.5% of GDP is the NATO defence spending average, critics thus maintain that Canada is skimping on its alliance obligations.

Per capita comparisons of NATO military expenditures cast Canada in a slightly more positive light. According to NATO figures, Canada spends approximately US$300 per capita on defence.[6] This ranks Canada thirteenth in NATO, ahead of middle-powers Poland, Hungry, the Czech Republic, Turkey and Spain, but behind Italy, Denmark, Norway and Greece. It should nonetheless be noted that Canada's per capita defence spending is only half the NATO average. Hence, Canada can still be accused of free-riding according to per capita defence spending data.

When defence spending is measured in real dollars, however, Canada's standing in NATO improves remarkably and allegations of free-riding are called into question. Canada's 2002 defence budget made it the eighth highest spender in NATO and the fifteenth highest in the world.[7] Within NATO, the only countries ahead of Canada in real spending are the United States, the United Kingdom, France, Germany, Italy, Turkey, and Spain. The United States is the world's sole superpower. France, Germany and the United Kingdom are large powers. Among the NATO middle powers, then, only Italy, Turkey, and Spain marginally outrank Canada in defence spending.[8] Arguably, therefore, given the state of its real defence spending, it is erroneous to label Canada a NATO free-rider.

Owing to these divergent results, comparative assessments provide an imperfect evaluation of Canadian military expenditures. Depending on the numbers and methodology used, Canada is either a lazy or praiseworthy ally. More importantly, it is worth asking whether an appropriate level of defence spending can be discerned from an intra-alliance comparison. Not all members of an alliance face the same geostrategic, economic or normative concerns. NATO members Turkey and Greece, for example, rank first and second in defence spending as a percentage of GDP. This is not because they are especially devoted to the alliance, but because they harbour longstanding suspicions of each other. While alliance membership may be *a* factor determining a country's military expenditure, it is not *the* factor. Consequently, an intra-alliance comparison should not be used as the primary gauge of Canadian defence spending sufficiency.

A better assessment of Canada's defence spending adequacy is arrived at by asking whether or not the CF is able to fulfill the defence policy goals set out by the government. The 1994 White Paper requires that the CF accomplish three tasks: defend Canada; defend North America in cooperation with the United States, and; contribute to international peace and security thorough multilateral forums.[9]

Canada's defence 'dilemma' is simplified by the fact that it is not directly threatened by any conventional military power. Most incursions into Canada's sovereign areas are commercial or criminal. The same is true for North America in general. Hence, the CF need not be equipped to defend Canada or North America against a large-scale military offensive. And even if such an offensive were to be launched, forces assigned to United States Pacific, Northern and Southern Command would not hesitate to defend Canadian territory, if only to defend the US itself.

Terrorism is the threat confronting North America today, but conventional military forces are ill-suited to protect the continent against this type of threat, beyond providing surveillance and interception support. An effective defence against terrorism focuses on intelligence, surveillance, espionage, policing, and immigration and refugee policy reform. These are primarily civilian functions. In the United States, the Department of Homeland Security was created to coordinate civilian counter-terrorism efforts. In Canada, the newly formed Department of Public Safety and Emergency Preparedness (DPSEP) performs essentially the same task. In both countries, the military is expected to buttress these civilian departments rather than play the lead role in counter-terrorism.[10]

In the post-9/11 environment, the CF's principle contribution to Canadian national security is forward defence - that is, prosecuting the war on terror overseas. Apart from concerns about operational tempo and obsolete equipment, the CF has played an admirable part in the 'War on Terror'. As part of Operation APOLLO, Canada deployed infantry and special forces to Afghanistan. In addition, the Canadian navy deployed a series of naval task groups to the United States Central Command (CENTCOM) area of responsibility (AOR) between October 2001 and December 2003. Whereas many in the defence community lamented Canada's purportedly minimal role in Afghanistan, the White House commended Canada's involvement, noting that "Canada contributed the first coalition Task Group to arrive in CENTCOM AOR."[11]

In August of 2003, Ottawa re-deployed the CF to Afghanistan as part of NATO's International Security Assistance Force (ISAF). Known as Operation ATHENA, the CF's ISAF contribution consists of approximately 2,000 troops in two six-month rotations. These deployments make Canada's contribution to ISAF the largest in NATO.

Although the CF will be unable to deploy significant formations for some time after the end of OP ATHENA, the fact remains that Canada's military will have been an active and respected partner in the war on terror for three years. More importantly, the CF will have done so on a defence budget many decry as inadequate. At the very least, this suggests that critics have been overly pessimistic about Ottawa's funding of the military. Indeed, the CF's performance in the war on terror may imply that Ottawa has been fairly astute about how much money the Department of National Defence (DND) requires to fulfill the defence policy objectives of the 1994 White Paper.[12]

Assuming that the federal government has correctly gauged the amount of funding DND requires, it should be asked whether Canada would benefit or be harmed by an increase in military expenditure. Clearly, were Ottawa to substantially increase the defence budget, the CF might be able to address embarrassing shortfalls and avoid being overstretched and demoralized in the future. However, while increasing the defence budget would aid the CF, greater military expenditures would likely undermine Canada's economic security.

Canada's federal debt stands at $507.7-billion.[13] According to the department of finance, this translates to a federal debt that is 44.5 % of GDP. Unless the federal debt is reduced to 25% of GDP over the next two decades, many economists estimate that the federal government will be confronted with a fiscal calamity.[14] To be exact, economists argue that the federal government must significantly reduce its interest payments on the debt in order to absorb the economic impact of the 'baby boomer' retirement.

If the interest payments on the debt are not reduced by the time the 'baby boomer' generation retires – at which point it ceases to pay taxes and begins to draw social benefits - the Organization for Economic Co-operation and Development (OECD) holds that Canada's GDP may fall by 8%, and the boomers' children will be expected to pay ever more taxes to maintain their parents' benefits.[15] Were this to happen, the "consequences for economic growth and emigration from Canada would likely be very serious."[16] Though finance minister Ralph Goodale plans to devote $3-billion a year to debt reduction, this amount will not be enough to reduce the federal debt to 25% of GDP before the boomer retirement. As a result, economists Christopher Ragan and William Watson warn that "A fiscal crunch is coming in Canada."[17]

In light of this urgent need to reduce the federal debt, calls to increase defence spending are imprudent. Every additional dollar spent on the military is a dollar that could be spent on debt reduction.[18] While members of the defence community tend to believe that national security trumps economic security, the cost of the baby boomer retirement cannot be ignored. Truth be told, if debt reduction is not prioritized today, there will be even fewer defence funds available in the future. Hence, if current funding levels are adequate to meet Canada's defence policy goals, and if greater defence spending would harm necessary debt reduction efforts, then increasing military expenditures is bad policy.

The Capital Equipment Crisis

Although the Canadian defence budget is sufficient to fulfill Ottawa's short-term defence policy objectives, the distribution of the defence budget must be examined to assess the CF's long-term viability. Defence budgets are sub-divided into three categories: personnel, operations and maintenance (O&M), and capital expenditures. Personnel expenditures cover salaries and allowances. The size of the personnel budget thus sets how many soldiers and civilian officials are part of an armed force. O&M expenditures pay for deployments and equipment repairs. The O&M budget thus determines the number and type of missions an armed force can accomplish. Personnel and O&M expenditures, then, fund a military's *current* capabilities. The capital budget, on the other hand, is a measure of an armed force's *future* capabilities. Capital budgets determine how much will be spent on new platforms, such as aircraft, vehicles, and ships. Deciding the composition of a defence budget, therefore, involves a trade-off between short-term expenses (personnel and O&M) and long-term investments (capital).

Currently, the Canadian defence budget prioritizes short-term expenses over long-term investments. Personnel and O&M costs have eroded capital's share of the defence budget for two decades. Since a recommended high of 30% in 1983, capital expenditures have fallen to approximately 15% of the defence budget in 2003.[19] As detailed in *Canada Without Armed Forces?*, capital's subordination to personnel and O&M costs prohibits the replacement of several obsolete CF platforms. While DND will be able to replace the Sea King helicopters and buy the Mobile Gun System to replace the Leopard tank, it is uncertain that the capital budget will be sufficient to acquire an expanded airlift capability, modern artillery, or new destroyers to succeed the aging *Iroquois*-class ships.

In addition, the capital budget will be at pains to afford information technologies – such as command, control, communications, computers, intelligence, surveillance and reconnaissance (C4ISR) equipment – that the CF needs to remain interoperable with the American armed forces. Indeed, the current emphasis on a technology-driven defence 'transformation' is not only demanding that militaries acquire more advanced technology more often, it is also pushing the price of military equipment higher. Hence, beyond its subordination to personnel and O&M, the purchasing power of the DND capital equipment budget is shrinking. Each of these factors is harming the long-term viability of the CF. Though the Canadian military weathered the increase in operational tempo which accompanied the budgets cuts of the 1990s, reduced capital expenditures have harmed DND's ability to maintain the CF's current capabilities in the future.

All told, the authors of *Canada Without Armed Forces?* are right to worry about the future potency of the CF. From a political perspective, Ottawa's zealous deployment of the CF between 1993-2003 was advantageous in that contributions to successive peace support operations and the war on terror upheld Canada's standing as a resolute defender of international peace and security. Yet to pay for these deployments, O&M expenditures were permitted to pilfer the capital equipment budget. Consequently, DND lacks the wherewithal to maintain the current CF force structure in the future. Indeed, over the next five years, *Canada Without Armed Forces?* calculates that DND will need an additional $15-billion to replace or modernize aging and obsolete equipment.[20] If this equipment is not replaced or modernized, many existing CF capabilities will be either unavailable or technologically sub par within a decade. In turn, future Canadian contributions to international peace and security may be jeopardized.

The Specialization Solution

Given that Ottawa cannot afford to spend much more on defence without harming Canada's fiscal health, and since the CF cannot maintain its current capabilities in future, it is logical for DND to focus its limited capital expenditures on a more specialized force structure.

The CF currently has a relatively balanced force structure. 'Balance' refers to the number of tasks an armed force can perform.[21] The more balanced the force, the more tasks is can accomplish. A fully balanced force is one able to operate across the entire spectrum of conflict, from aid of the civil power to thermonuclear war. Countries who chose not to retain capabilities for the entire spectrum of conflict engage in varying levels of specialization. Thus the difference between a fully balanced force and a one task force is a matter of degree.

Politically, the current CF force structure is valuable since it allows Canada to participate in a variety of overseas operations. Each service, moreover, has worked to be interoperable with the forces of Canada's ally of choice, the United States. Economically, however, DND's inability to renew the current force structure presents Ottawa with a dilemma. If the current force structure is retained, the capital budget will be spread too thin. Such an outcome would be politically embarrassing and a sub-optimal use of the limited capital expenditures available.

A second option would be to reduce CF deployments, thereby allowing capital expenditures to take a larger portion of the overall defence budget. However, this course of action would constrain Ottawa's policy of contributing a visible Canadian military presence to American-led coalitions and peace support operations. In truth, it is doubtful that Ottawa could resist imposing a high operational tempo on the CF. As former Prime Minister Jean Chrétien once remarked, the CF needs to "always [be] there, like the Boy Scouts."[22] Calls to re-organize the defence budget in favour of capital, while doubtlessly sage, are unlikely to be heeded.

Further specializing the CF, on the other hand, offers Ottawa a compromise. By focusing DND's limited capital funds on a smaller set of capabilities, Canada might be able to field future forces of sufficient technological standards to interoperate with the United States military, while preserving an O&M budget large enough to support a high operational tempo.[23] A discussion of which capabilities should be prioritized by DND is beyond the scope of this study. Nevertheless, it can be said that a more specialized CF should focus on those capabilities hose capabilities best suited to interoperate with the United States military (both overseas and in defence of North America),[24] and those visible enough to uphold Canada's reputation as a resolute defender of international peace and security.

Conclusion

The authors of *Canada Without Armed Forces?* reject a greater specialization of the CF. In their estimation, only a serious commitment to increase defence spending and re-organize the defence budget to the benefit of capital expenditures can ensure the future saliency of the Canadian military. Unfortunately, this argument is devoted to an 'ought', instead of being grounded in the 'is'. Ideally, funds needed to maintain the current CF force structure would be provided by the government. Realistically, however, Ottawa is likely to recoil at the cost of doing so; those in power do not have the luxury of bracketing the government's other fiscal priorities when evaluating the defence community's funding demands.

While it would inevitably limit the type of operations the CF could be part of, specialization offers a solution to Canada's defence spending dilemma which could preserve a high operational tempo, interoperability with the United States military, and a fiscally sound defence budget.

Notes:

[1]Notable exceptions include the defence budget analyses of John M. Treddenick and studies of the Canadian defence industrial base undertaken by David G. Haglund and Alistair Edgar.

[2]Andrew Cohen, *While Canada Slept* (Toronto: McClelland & Stewart Ltd., 2003).

[3]Denis Stairs, et al. *In the National Interest: Canadian Foreign Policy in an Insecure World* (Canadian Defence and Foreign Affairs Institute, 2003).

[4]Douglas Bland, et al. *Canada Without Armed Forces?* (Kingston: Queen's University School of Policy Studies, 2003).

[5]North Atlantic Treaty Organization, *NATO Review* (Summer 2003); available at http://www.nato.int/docu/review/2003/issue2/english/statistics.html

[6]Ibid.

[7]*The Military Balance 2003-2004* (London, UK: The International Institute of Strategic Studies, 2003).

[8]It should also be noted that Turkey borders the Middle East, arguably the world's most volatile region. Italy shares the Adriatic sea with the Balkans, historically hostile region. Spain is dealing with Basque separatists. Canada, on the other hand, has harmonious relations with its North American neighbours.

[9]Canada, Department of National Defence, *Defence White Paper* (1994).

[10]For an examination of CF capabilities in this critical area, see Philippe Lagassé, "Credit, Fault and Caution: The Canadian Forces and Continental Security," in David Rudd and David S. McDonough, eds., *The 'New Security Environment': Is the Canadian Military Up to the Challenge?* (Toronto: The Canadian Institute for Strategic Studies, 2004).

[11]United States, White House, *Campaign Against Terrorism: A Coalition Update*, March 2002.

[12]For an elaboration of this argument see Joel J. Sokolsky, "Clausewitz, Canadian Style?," *Canadian Military Journal*, Vol. 3, No. 3 (Autumn 2002).

[13]Canada, Department of Finance, *The Budget in Brief 2003*, 27.

[14]Christopher Ragan and William Watson, "Is the debt war over? Introduction and summary," in Christopher Ragan and William Watson, eds. *Is the Debt War Over?* (Montreal: Institute for Research on Public Policy, 2004), 29.

[15]Ibid., 40.

[16]Ibid.

[17]Ibid., 43.

[18]This is not to say that Ottawa will concentrate on debt reduction if it does not increase defence spending. However, since Ottawa is unlikely to cut other social programs to reduce the debt, not increasing defence spending offers the possibility that budget surpluses could be used for debt reduction instead of military expenditures.

[19]Brian MacDonald, "The Capital and the Future Force Crisis," in Bland, et al. *Canada Without Armed Forces?*, 41.

[20]Ibid., 44.

[21]Arthur Grimes and James Rolfe, "Optimal Defence Structure for a Small Country," *Defence and Peace Economics* 13 (2002), 272.

[22]Quoted in "Peacekeepers: Military Budget Puts Constraints on Canadians, *Washington Post*, 26 September 1999, A25.

[23]For comparable argument see Andrew Richter, " 'Alongside the Best?' The Future of the Canadian Forces," *Naval War College Review*, Vol. LVI, No. 1, (Winter 2003).

[24]Joel Sokolsky, Dean of Arts at Royal Military College (RMC), notes that specialization should focus on units able to perform both continental and international security tasks: "This would have the advantage of fostering cooperation with the United States in its homeland security efforts as well as being able to contribute to overseas operations, where America really intends to fight the war on terrorism." Quoted from author's correspondence with Joel Sokolsky, 3 February 2004.

Philippe Lagassé is a doctoral student in the department of political science at Carleton University and a pre-doctoral fellow with the Centre for Security and Defence Studies (CSDS), Norman Paterson School of International Affairs (NPSIA), Ottawa.

The views expressed are those of the author and do not necessarily represent those of the CISS or its members.

Copyright 2004

About the CISS

The Canadian Institute of Strategic Studies meets a need for a body of information on Canadian security issues and promotes public awareness of the significance of national and international developments. The CISS provides a forum for discussion of strategic matters, and through its educational and informational activities seeks to improve the basis for informed choice by the Canadian public and its leaders.